BRIEF IN SUPPORT OF FOREGOING PETITION.

Opinions Below.

The opinion of the Board of Tax Appeals is reported in 44 B.T.A. 1123, and is printed on pages 71-81 of the Record. The opinion of the Circuit Court of Appeals is reported in F. (2d) , and is printed on pages 90 *et seq.* of the Record.

Jurisdiction.

Reference is made to the foregoing petition for a statement of the jurisdiction of this Court and the statement of the case.

Argument.

1. The principal question here involved relates to the correlation of the gift tax and the estate tax. The two taxes are not necessarily imposed upon the same thing. The gift tax expressly applies to "the transfer of property * * * by gift."[1] The estate tax not only applies to "the transfer of the net estate" of decedents dying,[2] but also applies where, by reason of certain described transfers, made prior to death, as well as by reason of certain other described circumstances, death "has brought into being or ripened" property rights[3] and the transfers are "too much akin to a testamentary disposition not to be subject to estate tax."[4] Consequently, there can be no correlation

[1] Internal Revenue Code, Sec. 1000 (a).
[2] Internal Revenue Code, Sec. 810.
[3] See *Tyler* v. *United States*, 281 U.S. 497, 503.
[4] See *Helvering* v. *Hallock*, 309 U.S. 106, 112.

of the two taxes except where the estate tax is imposed upon a transfer at death. In all the gift tax decisions on the point, other than the one below in this case, it has been so held.

The absence of correlation in the case of gifts in contemplation of death was referred to by this Court in the *Sanford* case. The Court below has set forth three other instances where there is no correlation. The first appears in *Commissioner* v. *Prouty,* 115 F. (2d) 331, wherein a transfer in trust, with a reservation of power in the donor-settlor, in conjunction with a person having a substantial adverse interest, was held a taxable gift, although this Court had held in *Helvering* v. *City Bank Farmers Trust Co.,* 296 U.S. 85, that the property transferred was, in such a case, still includible in the donor's gross estate for estate tax purposes. The second instance is found in *Helvering* v. *Robinette,* F. (2d) (March 23, 1942), upholding gift tax on a transfer in trust with a life estate reserved to the grantor, although the trust property is includible in the donor's gross estate under *Helvering* v. *Bullard,* 303 U.S. 297. The third instance appears in *Commissioner* v. *McLean,* F. (2d) (April 23, 1942), and *Commissioner* v. *Marshall,* 125 F. (2d) 943, wherein the gift tax was held to apply to the value of the intermediate interests created, where there was a possibility of reverter to the grantor, although the entire property is includible in the grantor's gross estate for purposes of the estate tax under *Helvering* v. *Hallock,* 309 U.S. 106. Another instance, not referred to by the Court below, is where there is a transfer by a taxpayer of property to himself and spouse as tenants by the entirety. Under *Lilly* v. *Smith,* 96 F. (2d) 341, the gift tax applies, although this Court has held in *Tyler* v. *United States,* 281 U.S. 497, that the entire property can be included in the taxpayer's gross estate under the estate tax. A final instance may be noted in the case of

the designation of a beneficiary of life insurance without power in the insured to revoke. Under Regulations 79 (1936 ed.) Art. 2 (5), the designation is a taxable gift, yet under *Chase National Bank* v. *United States,* 116 F. (2d) 625, the insurance is included in the insured's estate for purposes of the estate tax where there is a possibility of reverter to his estate.

Where, however, there is an actual transfer at death, correlation between the gift tax and the estate tax exists. Such was the case in *Burnet* v. *Guggenheim,* 288 U.S. 280, wherein the reservation by a grantor of complete power to revoke and amend was held not to result in gift tax. There was a transfer of legal title under property law, but there was not the transfer of substantial economic benefits of ownership, which is controlling in tax cases. See *Helvering* v. *Hallock,* 309 U.S. 106, 111; *Reinecke* v. *Smith,* 281 U.S. 376, 378. In the corresponding situation under the estate tax, in *Reinecke* v. *Northern Trust Co.,* 278 U.S. 339, the estate tax was held to apply. Here there was no extension of the estate tax by description to reach an *inter vivos* transfer. The transfer was a transfer at death, and here we have correlation.

The *Sanford* case, like *Burnet* v. *Guggenheim,* presents a situation in which there was no transfer of the substantial economic incidents of ownership when the trust was created. The grantor retained power to change beneficiaries, substitute new ones and do anything he wished except name himself as beneficiary. Clearly there was no completed gift. In *Porter* v. *Commissioner,* 288 U.S. 436, the trust property was held includible in the grantor's gross estate under the estate tax. As this Court noted in the *Sanford* case, 308 U.S. 39, 43, the taxable transfer in the *Guggenheim* and *Sanford* cases was "the passage of control over the economic benefits of property rather than any technical changes in its title," and such transfer took place at death.

In the instant case, it is clear that "control over the economic benefits" passed when the trust was created. At that time the grantor gave up any right to get back the property, change beneficiaries, or substitute new beneficiaries. When, in 1938, he released his power to distribute among the very limited class of beneficiaries and turned that narrow power over to the trustees there was not the passage of "control over the economic benefits of property" referred to in the *Sanford* case. The transfer of such control had already taken place. The gift tax was not applicable to the relatively insignificant change that took place in 1938 when the trustees, rather than the grantor, became holders of the power to determine distributions among the limited class of beneficiaries.

The Court below in its opinion observed that in *Chickering* v. *Commissioner,* 118 F. (2d) 254, certiorari denied, 314 U.S. 636, it had held that the retention of control over the distributions among a limited class of beneficiaries rendered the property includible in the gross estate of the grantor under the estate tax as the retention of a power to "alter, amend, or revoke." This, however, is one of the transfers during life to which the estate tax reaches out by description. No actual transfer at death takes place. But a transfer at death is not necessary under the estate tax. Under the gift tax, however, a transfer is necessary, and as in all the other situations above discussed where the estate tax reaches out by description to situations involving no transfer at death, there is an absence of correlation of the gift tax and the estate tax.

The crux of this case appears in the following portion of the opinion of the Court below:

> "But where the question arising in gift tax litigation is whether there has been a completed gift inter vivos, we are bound by the Sanford case to correlate the

> gift tax with the estate tax, without regard to what happens under the income tax; and if the gift is incomplete from the viewpoint of the estate tax it must be regarded as incomplete for purposes of the gift tax."

This statement ignores the four examples which the Court itself gave and the two additional examples given in this brief of instances wherein the gift was held incomplete for estate tax purposes, yet complete with respect to gift tax. In all of those cases the question was whether there had been a completed gift *inter vivos*. It is clear from them that where the estate tax reaches out by description to impose a tax without the existence of a transfer at death there can be no correlation of the gift tax and the estate tax. In such cases, and the instant one must be included in the group, the gift tax applies at the time the transfer is made and the overlapping of the gift tax and the estate tax is taken care of by the provision for credit against the estate tax.

While the gift tax is, as this Court pointed out in the *Sanford* case (308 U.S. at p. 44), "supplementary to the estate tax," it is clear from the legislative history of the gift tax that it was intended to supplement both the estate tax and the income tax. See Paul, *Federal Estate and Gift Taxation*, Secs. 17.01, 17.03, 17.20. Such an intention upon the part of Congress appears from the committee reports in connection with the Revenue Act of 1932. H.R. Rep. No. 708, 72d Cong., 1st Sess. (1932); 28 Sen. Rep. No. 665, 72d Cong., 1st Sess. (1932) 40. It also appears from the debate in connection with the gift tax amendment in 1924. 65 Cong. Rec. 3120, 3172 (1924). See also 65 Cong. Rec. 3173, 8095, 8096 (1924). The Court below admitted that the gift tax was "designed to buttress both the estate tax and the income tax."

The Court below in its opinion points out how the gift tax can be integrated with the estate tax and the income tax, but discards the suggestion that the gift tax must perfectly supplement either of them. The Court below attaches little significance to the provision of the estate tax law [5] providing for a credit against estate tax where there is an overlapping of estate and gift taxes. The existence of such a provision would seem an indication that in case of conflict among the three taxes, the gift tax is to be integrated with the income tax and the overlapping of the estate and gift taxes is to be cared for by the credit. The Court below purports to rely on this Court's opinion in the *Sanford* case, which, while recognizing (p. 47) that "one purpose of the gift tax was to prevent or compensate for loss of surtax upon income where large estates are split up for gifts to numerous donees," emphasized the integration of the gift tax with the estate tax as providing "a unified system of taxation of gifts whether made inter vivos or at death." The Court below recognized that the income from the trust property in the *Sanford* case might have been no longer taxable to the donor, but concluded, in footnote (6), that imposition of the gift tax would be ineffective as a discouragement of such transfers or as compensation for the loss of surtax revenue in view of the gift tax credit allowed in computing estate tax. Here the Court completely disregards the legislative purpose of the gift tax. In many cases the imposition of the gift tax would discourage such gifts. At least Congress thought so when it enacted the gift tax. The Court below not only has adopted a defeatist attitude as to the accomplishment of the purpose of the gift tax, but has failed to follow the intent of Congress where such intent clearly appears. But it is for Congress to determine whether or not the statute

[5] The present provision is Section 813 of the Internal Revenue Code.

is successful. The Court is charged only with ascertaining the intent of Congress and with carrying out that intent.

2. The Court below has taken direct issue with one of the reasons upon which this Court based its decision in the *Sanford* case. In that case this Court pointed out (308 U.S. 39, 46) that "It can hardly be supposed that Congress intended to impose personal liability upon the donee of a gift of property so incomplete that he might be deprived of it by the donor the day after he had paid the tax." Yet the Court below has declared that "certainty or uncertainty of benefit from the standpoint of the donees is not the test of the incidence of the gift tax." While it may not be the sole test, certainly it is, as this Court indicated in the *Sanford* case, one of the factors to be considered in deciding whether or not gift tax should be imposed. In the instant case it is an important factor, since it is clear that from the standpoint of the beneficiaries it could make little difference whether the grantor or the trustees made the determination as to what amount each beneficiary was to have.

3. The transfers to the donees in this case were no more complete after March 10, 1938, than they had been prior thereto, since after that date the trustees possessed substantially the same powers that the taxpayer had theretofore held. In holding that a taxable transfer took place in 1938, therefore, the decision of the Court below conflicts with the decision of the Court of Claims in *Cockrell* v. *United States,* 39 F. Supp. 148. See Paul, *Federal Estate and Gift Taxation* (1942) 1168. In the *Cockrell* case trustees were given "such additional powers as the Settlor by any future instrument in writing delivered to the Trustees may grant to them * * *." The Court held that the gifts were incomplete and not subject to gift tax since (p. 153), "So long as this power remained in the hands of the settlor, the remaindermen could never be sure what in-

terest in the trust property, if any, they might eventually receive." In the instant case the trustees, after March 10, 1938, had power to distribute income and principal among the beneficiaries in such proportions as they saw fit. If, therefore, it be held that the gift was incomplete prior to March 10, 1938, it was no more complete after that date, since the powers formerly held by the taxpayer were thereafter in the hands of trustees not having any substantial adverse interest. Cf. *Reinecke* v. *Smith,* 289 U.S. 172; *Commissioner* v. *Prouty,* 115 F. (2d) 331.

4. The Court below refused to give prospective application to Article 3 of Regulations 79, upon which the taxpayer relied, stating that the taxpayer, by asking the Court to hold, "by force of such regulation, that the gift was complete in 1920, when he created the trust reserving in himself no power to regain the beneficial title," was "really contending for a retroactive application of the 1936 regulation." It is submitted that such a statement of the issue with respect to the effect of the gift tax Regulations in this case is clearly in error. The issue is whether, by virtue of what occurred in 1938, gift tax should be imposed for that year, not whether gift tax should have been imposed for 1920, when the trusts were created. This Court, in the *Sanford* case, moreover, did not have before it the question of whether the 1936 Regulations could be given effect prospectively, and merely held that the Regulations would not be given retroactive effect. In *Commissioner* v. *Prouty,* 115 F. (2d) 331, the Circuit Court of Appeals for the First Circuit gave prospective application to Article 3 of the 1936 Regulations 79 in a situation wherein the grantor of a trust reserved power, together with one having a substantial adverse interest, to revoke or amend the trust.

5. The action of the Court below, in giving retroactive application to the 1940 Regulations and in giving no effect

to the 1936 Regulations, ignores completely the fact that the transactions here in question took place at a time when the 1936 Regulations were in force expressly negativing any tax liability, that the 1936 Regulations remained outstanding for more than two years thereafter, and remained unchanged through five successive Revenue Acts. About two years after the transactions in question took place the 1936 Regulations were amended so as to impose a tax liability. The decision below runs counter to the rule set forth by this Court in *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U.S. 110, 116. See *Helvering* v. *Reynolds*, 313 U.S. 428, 432.

For the foregoing reasons it is respectfully submitted that this petition for writ of certiorari should be granted.

Respectfully submitted,

LAWRENCE E. GREEN,
Counsel for Petitioner.

Of Counsel:

RAYMOND B. ROBERTS,
GEORGE E. RAY.